CENTRAL INTELLIGENCE AGENCY
National Foreign Assessment Center

6 February 1980

MEMORANDUM FOR: Mr. F. Lisle Widman
Deputy Assistant Secretary for
International Monetary Affairs
Department of the Treasury

SUBJECT : The Future Role of Gold and Credit in Soviet Balance of Payments Decisionmaking [redacted] 25X1

1. We agree that at the current high price of gold, the USSR would not be hurt by a credit embargo in the near term. The volume of Soviet oil exports for hard currency, however, declined on the order of 20 percent in 1979, and we project an even larger decline in 1980. By 1982 (assuming oil deliveries to CEMA continue at current levels) Moscow is expected to become a net importer of oil for hard currency. Soon thereafter, hard currency constraints -- even allowing for very high gold prices and the availability of export credits -- will hold oil imports to well below needed levels. [redacted] 25X1

2. In large part, new credit extensions would cover equipment which would not be delivered until 1981 or later. Soviet decisionmaking regarding the need for Western credits is therefore tied to balance-of-payments perceptions for 1981 and beyond. While Moscow can count on earning several billion from gold in this period, it also must deal with the likely loss of earnings from oil sales, which probably exceeded $8 billion last year, and the prospect of financing a growing need for oil imports. In this environment a credit cutoff would force a major reduction in non-oil imports and would hit especially hard on those items, equipment and pipe, that traditionally have been financed by credits. [redacted] 25X1

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ON FILE DEPT. OF TREASURY RELEASE INSTRUCTIONS APPLY

[redacted] Chief
Soviet Trade Branch
USSR/Eastern Europe Division
Office of Economic Research 25X1

[redacted]

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UNITED STATES GOVERNMENT

Department of the Treasury
Washington, D.C. 20220

Memorandum

TO : Mr. Foster Collins

DATE: January 29, 1980

FROM : F. Lisle Widman

SUBJECT: CIA Memorandum Entitled "Soviet Gold Sales in 1979 and Prospects for the 1980s"

This memorandum is quite misleading. It totally obscures the major point: At the current gold price, the USSR could finance a current account deficit of as much as $6 to $8 billion a year out of current gold production. Thus the Soviets would not be dependent on foreign credit in order to finance a trade deficit unless it were several times as large as the deficits of recent years. Moreover, if the current account deficit is small, the Soviets will not even need to sell all of their current gold production and will be in position to put further upward pressure on the gold price by reducing the volume of their sales.

These are the key points that were missing in the Agency's earlier assessments of the impact of a credit cut-off. This is why Deputy Secretary Carswell was complaining. I think the Agency ought to issue a correction which sharply and bluntly brings out the above conclusions.

cc: Messrs. Carswell, Solomon, Bergsten, Hufbauer

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SECRET

CENTRAL INTELLIGENCE AGENCY
National Foreign Assessment Center

4 February 1980

MEMORANDUM FOR: Mr. F. Lisle Widman
Deputy Assistant Secretary for
International Monetary Affairs
The Department of the Treasury

SUBJECT : The Future Role of Gold and Credit in Soviet Balance of Payments Decision-making

1. A downturn in Soviet oil production will create massive balance of payments problems in the mid-1980s which cannot be rectified by heavy gold sales even if combined with continued access to government-guaranteed credits. After 1981 the USSR could become a net importer of Western oil if it chooses to maintain its export commitments to Eastern Europe. The required oil imports would quickly become too expensive to manage. By 1985 we estimate that oil shortages caused by balance-of-payments limitations will force the USSR to operate its economy at less than full capacity. Under these conditions a credit embargo, by worsening the capital account in 1980-85, would lead to reduced imports of oil, grain, and/or equipment on almost a one-for-one basis. [redacted] 25X1

2. In dollar terms, the impact of a credit cutoff pales in comparison to the estimated financial gap between affordable and required oil imports which is expected in the mid-1980s. But a curtailment of government supported credits, in its broader sense, would hit the Soviets hard. Soviet import decisions on equipment and diameter pipe -- those items which qualify for government-supported credits -- depend more on the perceived gains from trade than balance of payments criteria. Not only would a credit embargo cause Soviet decision makers to reassess import plans, it would turn the clock back some 25 years and undo the great success Moscow has had in fostering a competitive environment among Western governments whereby the extension of long-term interest credits is recognized as a prerequisite to equipment sales to the USSR. [redacted] 25X1

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[redacted]

ERM 80-10090 25X1

[redacted]

3. A detailed analysis of these factors is attached for your information. We would be happy to discuss these issues further at your convenience. [redacted] 25X1

[redacted] 25X1

Chief
Soviet Trade Branch
USSR/Eastern Europe Division
Office of Economic Research

Attachment:
As stated.

The Soviet Balance of Payments After 1980

The Role of Oil

The USSR is estimated to have earned over $8 billion in hard currency from its oil sales last year despite a drop of 20 percent in the volume delivered to hard currency customers. The decline is expected to be even larger this year as the domestic energy balance tightens; by 1982 the USSR is expected to become a net importer of oil from the free world for its own and Eastern Europe's account. Given the rapid rise in oil prices, moving from a net exporter to a net importer of oil for hard currency will have a dramatic impact on the USSR's hard currency balance of payments. 25X1

Even under the most optimistic conditions regarding Soviet oil production and domestic energy use a shortage of hard currency will force the USSR to limit oil imports by 1984-1985 to undesirable levels. This assessment holds true even if the USSR (a) sells all gold out of current production and (b) continues to rely heavily on Western government-backed credits. Only if the USSR cuts off oil exports to Eastern Europe <u>and</u> the price of gold relative to oil rises to an unprecedented level could the USSR come close to having the hard currency to buy the oil it is expected to need. 25X1

Credit Embargo and the Capital Account

25X1

Under the conditions described above, a credit embargo can be viewed in terms of its effect on Soviet ability to finance needed imports after 1982, and particularly oil.

ERM 80-10090

In dollar terms the cost of a credit embargo can be measured by its impact on the capital account. Without access to additional export credits the Soviet capital account would quickly move from its projected slight deficit in 1979 to one of substantial deficits. These deficits would peak at over $3 billion in 1982 and fall to $1.7 billion in 1985 as repayments continue to reduce outstanding debt; over the 1980-1985 period the cumulative capital account deficit -- assuming commercial credits are rolled over -- would amount to roughly $12.5 billion. Should the USSR instead be able to increase its drawings of government-backed credits over the period to some $6 billion in 1985 the Soviets could keep the capital account in surplus throughout the period. Under this assumption the Soviet Union would accrue a $1 billion capital account surplus in 1985 and a cumulative surplus of $4 billion for the period. 25X1

The resultant swing in net resource transfer in 1980-1985 of $16.5 billion may represent the high end of a plausible range. Faced with the need to import substantial amounts of high-cost oil the USSR may opt to reduce equipment imports and thus depress drawings on official credits below postulated levels. In any event the credit cutoff would have a substantial impact on the USSR's balance of payments over the period and, all else equal, would force a major reduction in imports. 25X1

<u>Other Effects of a Credit Embargo</u>

The impact of a credit embargo goes well beyond balance of payments ramifications. The Soviet Union has worked hard to foster a competitive environment among Western countries whereby the extension of low-cost long-term credits has become a recognized prerequisite to selling equipment and pipe to the USSR. Its success in this endeavor has enabled Moscow to obtain large inflows of needed capital and technology at a nominal cost. (The rapid price rise in Soviet exports whose earnings are used to repay credits extended several years earlier has been particularly impressive in recent years.) [redacted] 25X1

Soviet foreign trade planners have counted on a continued extension of exports credits by Western governments in planning imports for the 1981-85 period. A credit embargo would force a major re-evaluation in the decision calculus; by raising the cost of imported versus domestically produced equipment it would likley result in a sizeable reduction in the amount of equipment to be purchased abroad. Equipment and technoloyg imports would be limited to items which would only be manufactured at high cost, if at all, domestically. Compensation deals -- which have become the backbone of Soviet trade planning with the West and which are predicated on long grace periods and lengthy credits maturities to bridge the lag between equipment imports and export earnings -- would be hardest hit. [redacted] 25X1

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A credit embargo, in effect, would turn back the clock some 25 years to the period when equipment imports were financed solely by hard currency earnings including heavy gold sales. Such as undoing of the Soviet effort to foster the competitive enviornment noted above would of itself be a major blow. [redacted] 25X1

Role of Gold

[redacted] 25X1 25X1 we feel that gold sales will play a significant role in Soviet hard currency trade. As a base we assume that the USSR will sell most, if not all, of its annual gold production as declining oil exports and later the need to import substantial amounts of oil put a premium on earnings from this source. A cutoff in credit could cause the USSR to build up gold stocks if they feel that they could no longer rely on commercial credits, as they did in 1975-1977, to compensate for unplanned imports or an unexpected reduction in export earnings. Alternatively, pressure to maximize merchandise imports over the short run could lead to substantial sales out of stocks. Nonetheless, even heavy sales of gold will be insufficient, regardless of assumptions with respect to government-backed credit, to finance projected import needs in the mid-1980s. [redacted] 25X1

CIA/OER
4 Feb 1980